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AUG 24 2005

T.S. McGREGOR, CLERK
U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

6 UNITED STATES BANKRUPTCY COURT

7 EASTERN DISTRICT OF WASHINGTON

8 In re:)
9 METROPOLITAN MORTGAGE &) Jointly Administered Under
SECURITIES CO., INC.,) No. 04-00757-W11
10 Debtor.)
11 _____)
12 In re:) MEMORANDUM DECISION RE:
13 SUMMIT SECURITIES, INC.,) RONALD PELLEGRINO'S MOTION
14 Debtor.) FOR LIMITED RELIEF FROM
15 _____) AUTOMATIC STAY (#4280)

16 Mr. Ronald Pellegrino was the general manager and briefly the
17 President of Metropolitan Investment Securities, Inc. ("MIS") prior
18 to the termination of the debtor's business in December, 2003.
19 Mr. Pellegrino held various licenses as a securities representative
20 from National Association Securities Dealers ("NASD"). After an
21 investigation, NASD commenced disciplinary proceedings against
22 Mr. Pellegrino in which it seeks to impose undefined sanctions. As
23 a former officer and director of MIS, Mr. Pellegrino sought
24 reimbursement for the costs of defending himself in the
25 investigation and disciplinary proceeding from the primary D&O
26 insurance policy for the three debtors, Metropolitan Mortgage &
27 Securities Co., Inc., Summit Securities, Inc. and Metropolitan
28 Investment Securities, Inc. That policy was issued by National

MEMORANDUM DECISION RE: . . . - 1

1 Union Insurance ("National Union") and is policy No. 263-38-69
2 which is the subject of the interpleader adversary No. 05-80135-
3 PCW. It is also one of the policies referenced in the Court's
4 Memorandum Decision issued June 20, 2005 in the adversary
5 proceeding *Metropolitan Mortgage & Securities, Inc., et al. v.*
6 *Keith Cauvel, et al.*, No. A04-00061-PCW, which determined that the
7 proceeds of certain insurance policies constituted property of the
8 bankruptcy estates. National Union has advised Mr. Pellegrino that
9 it would pay the costs of defense under a reservation of rights.
10 Without payment of the costs of defense from the policy proceeds,
11 Mr. Pellegrino would be unable to fund the defense. He is without
12 employment and is contemplating a personal bankruptcy.

13 The moving party in its Motion for Limited Relief from
14 Automatic Stay and in its oral argument seeks two forms of relief:
15 (1) A determination that the continuation of the disciplinary
16 proceeding constitutes a violation of the automatic stay; and (2)
17 a lifting of the automatic stay to allow the costs of defending the
18 proceeding be reimbursed from the insurance proceeds. NASD argues
19 that the stay does not preclude the commencement or continuation of
20 the disciplinary proceeding. Other objecting parties contend that
21 allowing distribution of some of the policy proceeds to reimburse
22 the costs of defense would deplete property of the estate and
23 should not be allowed.

24 The written decision issued June 20, 2005 (Adversary No. A04-
25 00061-PCW, Docket No. 223) concluded that the proceeds of the
26 insurance policies constitute property of the estate. Pursuant to
27 11 U.S.C. § 362, any act to collect or exercise control over that
28 property, i.e., a request to receive distribution of the proceeds,

MEMORANDUM DECISION RE: . . . - 2

1 would violate the automatic stay. That decision does not discuss
2 whether the continued existence of any specific lawsuit or
3 arbitration proceeding violates the automatic stay.

4 Issue: Is the Commencement or Continuation of the Disciplinary
5 Proceeding Stayed by 11 U.S.C. § 362?

6 As a general proposition, the stay does not prevent the
7 commencement or continuation of any legal proceeding by a third
8 party against a non-debtor even though the factual situation which
9 gave rise to the legal proceeding involved conduct of a debtor. In
10 this situation, the third party, the NASD, has commenced a
11 disciplinary action against Mr. Pellegrino, a non-debtor. Even
12 though Mr. Pellegrino may have been employed by a debtor, nothing
13 in 11 U.S.C. § 362 precludes the third party from taking action to
14 impose sanctions, monetary or otherwise, against that non-debtor.

15 Naming non-debtors as defendants and asserting claims against
16 the non-debtors is not a violation of the stay. Even though such
17 non-debtors may be jointly liable with a Chapter 7 or Chapter 11
18 debtor, their status as a joint obligor does not extend the
19 protections of the stay to them. Should one of the debtors be
20 named as a defendant or should a particular legal proceeding seek
21 "to recover a claim against the debtor," § 362(a)(1) stays the
22 legal proceeding. It is conceivable that some of the legal
23 proceedings referenced in the prior decision regarding insurance
24 policy proceeds would be subject to § 362(a)(1). However, it
25 appears that many of the legal proceedings now pending name only
26 non-debtors and seek to recover only claims against non-debtors.
27 Those legal proceedings would not be stayed. Any disputes
28 regarding applicability of § 362(a)(1) to a particular proceeding

MEMORANDUM DECISION RE: . . . - 3

1 would have to be resolved on a case-by-case basis. This NASD
2 disciplinary proceeding does not attempt to realize upon a claim
3 against the debtor and its continuation does not violate
4 § 362(a)(1).

5 Issue: Should the Stay be Lifted to Allow Mr. Pellegrino to
6 Seek Reimbursement of His Costs of Defense From the Insurance
7 Proceeds?

8 11 U.S.C. § 362(a)(3) does preclude any action to collect or
9 exercise control over property of the estate. Even though the
10 litigation itself does not violate the stay, any attempt to seek
11 reimbursement of defense costs or payment of a monetary judgment
12 from property of the estate would violate the stay. The proceeds
13 of certain insurance policies constitute property of one or more of
14 the bankruptcy estates. Any attempt to exercise control over those
15 policy proceeds, such as seeking a distribution of the proceeds
16 violates § 362(a)(3).

17 In other words, the continuation of the legal proceedings
18 referenced in the prior decision violate the stay only to the
19 extent there is an attempt to effect property of the estate, i.e.,
20 an attempt to collect a judgment or settlement amount resulting
21 from the legal proceeding. Mr. Pellegrino's request is that the
22 automatic stay be lifted so that he may effect property of the
23 estate, i.e., receive a distribution of the insurance proceeds to
24 reimburse his defense costs in this legal proceeding.

25 There appears to be a dispute as to whether Mr. Pellegrino is
26 entitled to receive benefits under the National Union policy and
27 share in the policy proceeds. This, however, is not the forum or
28 procedure to resolve that dispute. He seeks permission to seek a
29 distribution from the policy proceeds to pay his costs of defense

1 and for purposes of this motion, it should be assumed that he would
2 be entitled to do so under the terms of the policy.

3 Mr. Pellegrino argues that cause exists to lift the automatic
4 stay to allow the defense costs to be paid. He is unable to pay
5 those costs and the disciplinary proceeding could potentially
6 result in extremely serious long term adverse consequences. It is
7 likely, however, that many individual defendants to the numerous
8 lawsuits, NASD arbitration proceedings and class action litigation
9 are similarly situated. Even though the defense costs requested by
10 Mr. Pellegrino may be only a small portion of the policy proceeds,
11 as was previously found in the decision regarding the insurance
12 proceeds, the cumulative costs of defending all those legal
13 proceedings will greatly deplete the policy proceeds. As
14 sympathetic as the Court may be to those defendants who have no
15 means to pay the very significant costs of defense or any judgment,
16 any diminution of the proceeds reduces the value of the debtors'
17 rights to the insurance proceeds, thus potentially reducing
18 property of the estate otherwise available to pay creditors.

19 Balancing the rights of claimants such as Mr. Pellegrino
20 against the rights of the bankruptcy estates, leads to the
21 conclusion that the interest of the bankruptcy estates in the
22 policy proceeds must be preserved. As a general proposition, the
23 stay should not be lifted to allow distribution of insurance policy
24 proceeds. If a situation exists in which the equities require a
25 different result, the merits would have to be addressed in the
26 context of a motion addressing that situation.

27 Lastly, the effect of the existing interpleader action No. 05-
28 800135-PCW must be considered. That adversary proceeding was

1 commenced by National Union and placed the proceeds of policy No.
2 263-38-69 into the registry of the Court. The Complaint seeks a
3 determination of the respective interests of the numerous parties
4 who are, or may be, entitled to receive the policy proceeds.
5 Lifting the automatic stay to allow Mr. Pellegrino or similarly
6 situated defendants to seek reimbursement of defense costs or even
7 payment of monetary judgments rendered against those defendants is
8 inconsistent with the orderly administration of the interpleader
9 action and the orderly resolution of the issues in that adversary
10 proceeding.

CONCLUSION

12 The automatic stay is not applicable to the NASD litigation
13 against Mr. Pellegrino. However, the automatic stay prohibits
14 Mr. Pellegrino from seeking reimbursement of his defense costs, and
15 Mr. Pellegrino has not shown cause for lifting the stay.

16 DATED this 24th day of August, 2005.

Patricia C. Williams
PATRICIA C. WILLIAMS
Bankruptcy Judge

MEMORANDUM DECISION RE: . . . - 6